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No. _____

In the

Supreme Court of The United States

OCTOBER TERM, 1998

LYNDEN AIR FREIGHT, INC.,

Petitioner,

v.

DIRECTOR OF TAXATION, STATE OF HAWAII,

Respondent.

Petition for a Writ of Certiorari to the
Supreme Court of the State of Hawaii

PETITION FOR A WRIT OF CERTIORARI

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February 23, 1999

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QUESTIONS PRESENTED

1. Whether the preemption of state taxes on the sale of air transportation and on gross receipts from air transportation within the meaning of 49 U.S.C. § 40116(b), or its predecessor 49 U.S.C. § 1513(a), preempts a state tax on a portion of the gross receipts of an air carrier from the sale of air cargo services?

2. Whether the definition of "interstate air transportation" in 49 U.S.C. § 40102(a)(25), or its predecessor 49 U.S.C. § 1301(21), includes ground activity integral to the air transportation service of an air carrier?

LIST OF PARTIES

Pursuant to Rule 14.1(b) and Rule 29.6, the following list identifies all the parties to the proceeding before the Supreme Court of Hawaii.

Lynden Air Freight, Inc., a wholly owned subsidiary corporation of Lynden Incorporated, appellee below.
Lynden Incorporated has no non-wholly owned subsidiary corporations.

Ray K. Kamikawa, Director of Taxation, State of Hawaii, appellant below.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

LIST OF PARTIES ii

TABLE OF AUTHORITIES vi

OPINIONS BELOW 2

JURISDICTION 2

STATUTORY PROVISIONS INVOLVED 2

STATEMENT OF THE CASE 3

Background 3

Proceedings Below 4

REASONS FOR GRANTING THE PETITION 6

I. THIS COURT'S GUIDANCE IS NEEDED TO ADDRESS THE SUBSTANTIAL TRUNCATION OF THE FEDERAL STATE TAX PREEMPTION PROVISION ADOPTED BELOW 7

A. Aloha Airlines 7

B. This Is Not An Isolated Error Of Law . . 9

1. Hawaii 10

2. Other states; other taxes 12

II. THIS COURT SHOULD GRANT CERTIORARI BECAUSE THE DECISION BELOW IS INCONSISTENT WITH CONGRESS' UNDERSTANDING AND POSES AND POSES A SIGNIFICANT THREAT TO CONGRESS' EXPRESS GOALS 14

A. Hawaii's Designation Of Sorting, Marketing, Pickup And Delivery Functions As Separate From Air Services Conflicts With Congress' Views And Those Of Its Designated Agency 14

1. Air transportation services . . . 15

2. Congress and its designated agency considered the ground activities at issue here integral to the provision of air transportation services 16

B. Hawaii's Imposition Of Tax On Gross Receipts Attributed To Ground-Based Functions Integral To Providing Air Transportation Undermines Congress' Preemption Scheme 19

III. THIS COURT SHOULD GRANT CERTIORARI TO RESOLVE A LONG-STANDING CONFLICT OVER THE SCOPE OF THE STATUTORY DEFINITION OF INTERSTATE AIR TRANSPORTATION . . . 24

CONCLUSION 27

TABLE OF AUTHORITIES

CASES

Page

Air Polynesia, Inc. v. Director of Taxation, Docket No. 2250 (Haw. Tax Appeal Court May 24, 1985) 11

Air Polynesia, Inc. v. Freitas, 742 F.2d 546 (9th Cir. 1984) 11

Airborne Freight Corp. v. New York Dep't of Taxation, 527 N.Y.S.2d 107 (App. Div. 1988) 9

Airline Car Rental, Inc. v. Shreveport Airport Auth., 667 F. Supp. 293 (W.D. La. 1986) 25

In re Aloha Airlines, 647 P.2d 263 (Haw. 1982) . 10

Aloha Airlines, Inc. v. Director of Taxation of Hawaii, 464 U.S. 7 (1983) . . . . . *passim*

City and County of Denver v. Continental Air Lines, Inc., 712 F. Supp. 834 (D. Colo. 1989) 25

City of College Park v. Atlantic S.E. Airlines, Inc., 391 S.E.2d 460 (Ga. Ct. App. 1990) 8

City of Philadelphia v. C.A.B., 289 F.2d 770 (D.C. Cir. 1961) 25, 26

DHL Corp. v. C.A.B., 584 F.2d 914 (9th Cir. 1978) 4

Director of Taxation of Hawaii v. United Parcel Service, Inc., 966 P.2d 648 (Haw. 1998) 5, 10, 12

Evansville-Vanderburgh Airport Authority District et al. v. Delta Airlines, Inc. et al., 405 U.S. 707 (1972) 13

Federal Express Corp. v. California Pub. Utils. Comm'n, 936 F.2d 1075 (1991) 16, 25

Harper v. Virginia Dep't of Taxation, 509 U.S. 86 (1993) 7

Hill v. National Trans. Safety Bd., 886 F.2d 1275 (10th Cir. 1989) 25, 26

James B. Beam Distilling Co. v. Georgia, 501 U.S. 529 (1991) 7

Law Motor Freight, Inc. v. C.A.B., 364 F.2d 139 (1st Cir. 1966) 17, 18

Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356 (1973) 23

Newsweek, Inc. v. Florida Dep't of Revenue, 118 S. Ct. 904 (1998) 7

In re Panorama Air Tour, Inc., Docket No. 1931

(Haw. Tax Appeal Court Nov. 27, 1984) 11

Reich v. Collins, 513 U.S. 106 (1994) 7

Salem Trans. Co. v. Port Auth., 611 F. Supp. 254 (S.D.N.Y. 1985) 9, 24-25

Travel Services, Inc. v. Government of the V.I., 904 F.2d 186 (3d Cir. 1990) 8

UPS v. Director of Taxation, Docket No. 2235 (Haw. Tax Appeal Court Jan. 13, 1997) 12

United States v. Petrykievicz, 809 F. Supp. 794 (W.D. Wash. 1992) 26

STATUTES AND LEGISLATIVE HISTORY

49 U.S.C. § 40101 ..... 16, 19, 21

49 U.S.C. § 40102 ..... *passim*

49 U.S.C. § 40116 ..... *passim*

49 U.S.C. § 41712 27

49 U.S.C. § 13506 18

49 U.S.C.§ 1301(1988) ..... *passim*

49 U.S.C.§ 1302 (1988) 16, 21

49 U.S.C. § 1373 (1988) 17

49 U.S.C. 1513 (1988) ..... *passim*

Pub. L. 103-272, 108 Stat. 745 3

52 Stat. 1029 (1938), *codified as* 49 U.S.C. § 303(b)(7a) 17

Ariz. Rev. Stat. § 43.5062 12

Del. Code Ann., tit. 30, § 2301 12

Haw. Rev. Stat. § 237 3

Haw. Rev. Stat. § 239 3

N.M. Stat. Ann. § 7-9-4 12

Okla. Stat. § 68-1354(C) 12

Wash. Rev. Code § 82.16.020 12

H.R. Rep. No. 103-180, (1993), *reprinted in* 1994 U.S.C.C.A.N. 818 ..... 3, 8

S. Rep. N. 93-12 (1973), *reprinted in* 1973 U.S.C.C.A.N. 1434 ..... *passim*

Hearings on H.R. 4082, H.R. 2695, H.R. 4214, H.R. 4182 and S.38 Before the Subcomm. on Transportation and Aeronautics of the House Comm. on Interstate and Foreign Commerce, 93d Cong. (1973). 20

REGULATIONS AND MISCELLANEOUS

14 C.F.R. Pt. 222 (1998) 19, 26

14 C.F.R. Pt. 222 (1980) 17

29 Fed. Reg 6276 (1964) 17

Ohio Op. Atty. Gen. No. 73-117 (Nov. 20, 1973) . 20

John Piper and Catherine A. Eggen, *Gross Receipt Taxes: General Principles*, 1610 *Tax Management (BNA 1998)* 13

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DIRECTOR OF TAXATION, STATE OF HAWAII,

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Petition for a Writ of Certiorari to the
Supreme Court of the State of Hawaii

PETITION FOR A WRIT OF CERTIORARI

Lynden Air Freight, Inc., respectfully petitions for a writ of certiorari to review a judgment of the Supreme Court of Hawaii, which held that a federal law which "expressly preempts gross receipts taxes on the sale of air transportation,"[1] does not preempt Hawaii from taxing gross receipts from the sale of air cargo transportation to the extent such gross receipts can be attributed to the cost of activities that take place on the ground.

[1] *Aloha Airlines v. Director of Taxation*, 464 U.S. 7, 11 (1983).

OPINIONS BELOW

The Notice and Judgment on Appeal of the Supreme Court of Hawaii is reprinted at Pet. App. 1a. The opinion of the Supreme Court of Hawaii, reported as *Director of Taxation of Hawaii v. Lynden Air Freight, Inc.*, 968 P.2d 653 (Haw. 1998), is reprinted at Pet. App. 2a. The opinion of the Tax Appeal Court of Hawaii is reprinted at Pet. App. 18a.

JURISDICTION

The Supreme Court of Hawaii issued its opinion on November 25, 1998, and a Notice and Judgment on Appeal on December 23, 1998. The jurisdiction of this Court is properly invoked pursuant to 28 U.S.C. § 1257(a).

STATUTORY PROVISIONS INVOLVED

This case involves the definition of air transportation as originally enacted by the Civil Aeronautics Act of 1938, 49 U.S.C. § 1301(21), and the state tax preemption provision as originally enacted by the Airport Development Acceleration Act of 1973, 49 U.S.C. § 1513, and as both were recodified in 1994 as 49 U.S.C. §§ 40102(a)(25) and 40116(b), respectively. The pertinent portions of these statutes are reprinted at Pet. App. 21a through 23a.

STATEMENT OF THE CASE

Background. Hawaii imposes a general excise tax on gross receipts of manufacturers and service businesses, Haw. Rev. Stat. § 237, and on the gross receipts of public service companies, including airlines and motor carriers, Haw. Rev. Stat. § 239, to the extent Hawaii's Director of Taxation determines taxation is permitted by law. In *Aloha Airlines, Inc. v. Director of Taxation of Hawaii*, 464 U.S. 7 (1983) ("*Aloha Airlines*"), this Court held that Hawaii's excise tax on airlines was preempted by federal law because 49 U.S.C. § 1513 "expressly preempts gross receipts taxes on the sale of air transportation or the carriage of persons traveling in air commerce." *Id.* at 11.[2] In the intervening years, the State's Director of Taxation has imposed the state's excise taxes on companies providing air cargo and helicopter services, based on various narrowing interpretations of this Court's *Aloha Airlines* decision. *See* Pt. II.B.1.

Lynden Air Freight, Inc. ("Lynden") sells interstate and international air freight transportation services, from the customers' location to the freight's destination. Pet. App. 4a. Customers pay a single fee; one airway bill is used for the entire journey, and the sale is trSeated as a single item in Lynden's invoice and in its internal books and records. *Id.* at 5a; R.A. 202-06. Lynden hires airlines to transport the freight by air and motor carriers to perform the attendant pickup and delivery. Lynden, however, is responsible for, and retains control of, the entire transportation of the freight, and itself maintains sorting

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[2]Section 1513 was recodified as 49 U.S.C. § 40116 in 1994, *see* Pub. L. 103-272, 108 Stat. 745. The recodification was technical and not intended to make any substantive changes. *See* H.R. Rep. No. 103-180 (1993), *reprinted in* 1994 U.S.C.C.A.N. 818.

centers and offices near airports for handling and sorting functions, public relations and marketing. Pet. App. 4a-5a; R.A. 186, 202, 280. Some airports, such as Honolulu's, are used as a hub for shipment to and from other countries. Under federal law, Lynden is an "air carrier." *See* 49 U.S.C. § 40102(a)(2); DHL Corp. v. C.A.B., 584 F.2d 914, 915 (9th Cir. 1978).

Believing that Hawaii could not legally impose excise tax on its gross receipts from the sale of such services, Lynden did not pay this tax. Pet. App. 5a. On May 19, 1997, Hawaii's Director of Taxation assessed Lynden more than a half million dollars for tax years 1987 through 1994. *Id* at 5a-6a. The tax was determined by attributing a portion of Lynden's gross receipts from the sale of its air delivery services to those parts of the service that were performed on the ground. *Id.* at 5a. Specifically, the portion of Lynden's receipts subjected to tax was determined by the following formula:

Total Worldwide		Hawaii Ground Costs
Revenue from	x	----------
Air Freight Sales		Total Worldwide Costs[3]

Id. Forty percent of the Hawaii ground costs included were the costs of the ancillary pickup and delivery of freight before and after flight; 60 percent of the ground costs included were sorting center costs, including labor for receiving, handling, and sorting air freight; and administrative, office, public relations and marketing expenses. R.A. 186, 192.

Proceedings below. Lynden complied with Hawaii's procedures for challenging the assessments. It paid the tax

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[3]Total worldwide costs included not only worldwide ground costs, but also the worldwide costs of hiring aircraft.

under protest and sought a refund in the Tax Appeal Court. Pet. App. 7a. Lynden challenged the tax as preempted, but agreed -- if these taxes were not preempted -- to accept the specific amount assessed. R.A. 186. On January 28, 1998, the Tax Appeal Court granted Lynden's motion for summary judgment, finding that the revenues taxed were "derived from the sale of 'air transportation'" and that therefore the tax "is preempted by 49 U.S.C. Section 40116." Pet. App. 7a, 19a.

The Director of Taxation appealed the tax court's decision to the Supreme Court of Hawaii, which reversed. The court concluded that the tax was not preempted because the tax was imposed on receipts attributed to activities -- although part of the air freight service Lynden provides -- that took place on the ground. *Id.* at 8a. In so ruling, the Supreme Court of Hawaii expressly relied on its decision a few weeks earlier, in *Director of Taxation of Hawaii v. United Parcel Service, Inc.*, 966 P.2d 648 (Haw. 1998) ("*UPS*"), upholding a parallel excise tax on the "ground" portion of UPS's gross receipts from the sale of its air freight services. Pet. App. 8a. The court held that Hawaii could tax these portions of air freight service receipts because the handling, sorting, marketing, pickup and delivery functions were not performed in an aircraft and, in the court's view, were therefore not "air transportation" within the meaning of defined by 49 U.S.C. §§ 40102(a)(5), (25), and their predecessors 49 U.S.C. §§ 1301(10), (21).[4] Pet. App. 4a n.2, 10a-15a. Although the court expressed concern because it believed the taxes were "measured as a proportion of gross receipts derived in part from the sale of 'air transportation,'" *id.* at 16a, the court erroneously concluded that this issue had not been presented. *Id.*; *but see* Lynden Answ. Br. in No. 21434

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[4]Sections 1301(10) and (21) were recodified as 49 U.S.C. § 40102(a)(5) and (25) in 1994, without substantive change. *See* n.2, *supra*.

(Supreme Court of Hawaii), at 9 (expressly arguing that a state tax measured as a proportion of gross receipts that includes receipts from air transportation is preempted).[5]

REASONS FOR GRANTING THE PETITION

Certiorari should be granted for three reasons. First, the decision below reflects a concerted and consistent effort to substantially narrow this Court's decision in *Aloha Airlines*, and additional guidance from this Court is needed. Although reasonably encompassed in this Court's interpretation of the governing law in *Aloha Airlines*, the precise questions at issue -- whether federal law permits states (and localities) to apportion gross receipts from the sale of air transportation for tax purposes, and if so, whether tax may be imposed on gross receipts allocated to any activity that occurs on the ground -- were not presented by the facts of that case and therefore were not expressly addressed. They are squarely and cleanly presented here.

Second, the questions are significant. If allowed to stand, the decision below can be expected to have a widespread effect on the air transportation industry and its customers, contrary to Congress' express goals. It will influence many states and

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[5]The court appears to have misconstrued Lynden's concession. Lynden had conceded that if the State were permitted to tax the activities on which it had imposed tax, and were permitted to measure that tax by attributing a portion of Lynden's gross receipts from air freight services, Lynden would not challenge the specific calculations regarding the *amount* of the tax. R.A. 186. Lynden did, however, consistently challenge the State's ability to impose any tax measured by such gross receipts, and its ability to impose taxes on the handling, sorting, marketing, pickup and delivery functions that are a necessary part of its, and all other air cargo companies', air transportation services. Answ. Br. at 8-19.

localities, which used to impose taxes on air transportation before *Aloha Airlines*, and other states and localities that would welcome the revenues, to impose an identical tax, or a profusion of different taxes, on an industry Congress intended to develop free of such burdens. Third, the decision below highlights a long-standing conflict with respect to the statutory definition of "interstate air transportation," 49 U.S.C. § 40102(a)(25), and its predecessor 49 U.S.C. § 1301(21), which, because it is a definition, affects the scope of many provisions of federal law.

The decision below provides an excellent vehicle for this Court to clarify the scope of the state tax preemption provision it addressed in *Aloha Airlines*. As this Court is well aware, restrictions on state tax authority can require express clarification following the Court's initial interpretation of governing law in order to secure compliance. *See, e.g., James B. Beam Distilling Co. v. Georgia*, 501 U.S. 529 (1991); *Harper v. Virginia Dep't of Taxation*, 509 U.S. 86 (1993); *Reich v. Collins*, 513 U.S. 106 (1994); *Newsweek, Inc. v. Florida Dep't of Revenue*, 118 S. Ct. 904 (1998) . The decision below also provides an opportunity for the Court to resolve the conflict as to the meaning of the statutory definition of "interstate air transportation," which affects a range of federal and state powers with respect to the air transportation industry.

I. THIS COURT'S GUIDANCE IS NEEDED TO ADDRESS THE SUBSTANTIAL TRUNCATION OF THE FEDERAL STATE TAX PREEMPTION PROVISION ADOPTED BELOW.

A. *Aloha Airlines*

The decision below unreasonably narrowed this Court's interpretation of the federal state tax preemption provision.

Section 1513, and its successor provision, prohibit states and localities from imposing a tax, "directly or indirectly," on "the sale of air transportation or on the gross receipts derived therefrom.. . ." 49 U.S.C. §1513.[6] In *Aloha Airlines*, this Court interpreted the scope of that provision. It found the provision was intended by Congress to prevent a proliferation of state and local taxes burdening interstate air transportation, 464 U.S. at 9, and that it preempted certain "state taxes, including gross receipts taxes imposed on the sale of air transportation." *Id.* at 12 n.6. Further, this Court noted that Congress had expressly declined to permit gross receipts taxes on sales of air transportation, *even if* limited to receipts fairly apportioned to the taxing state. *Id.* at 13 n.7. Thus, this Court found that the Hawaii excise tax at issue in that case, a tax on the Aloha and Hawaiian Airlines' gross income, was preempted and noted that its decision would likely invalidate a number of other states' taxes. *Id.* at 14 n.10.

Lower courts, including the Supreme Court of Hawaii, have understood *Aloha Airlines* to mean that taxes on *total* gross receipts from the sale of air transportation are preempted. *See, e.g.*, Pet. App. 16a, *City of College Park v. Atlantic S.E. Airlines, Inc.*, 391 S.E.2d 460 (Ga. Ct. App. 1990). And several lower courts have distinguished, and upheld, taxes on the gross receipts from services related to the air transportation industry, when *no* part of the receipts is from the sale of air transportation. *See, e.g., Travel Services, Inc. v. Government of the V.I.*, 904 F.2d 186 (3d Cir. 1990) (upholding gross

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[6]As recodified, the provision prohibits state and local taxes on, *inter alia*, "the sale of air transportation; or the gross receipts from that air . . . transportation." 49 U.S.C. §40116(b)(3)-(4). The phrase "directly or indirectly" was removed only because it was considered surplusage. 1994 U.S.C.C.A.N. at 1089 (H.R. Rep. No. 103-180).

receipts tax on travel agents' commissions from airlines); *Salem Trans. Co. v. Port Auth.*, 611 F. Supp. 254 (S.D.N.Y. 1985) (upholding gross receipts tax on limousine service for permission to solicit business at airports).

The question this Court did not expressly address in *Aloha Airlines* that Hawaii, among others, considered open after that decision, is whether states and localities may tax *some* of the gross receipts from the sale of air transportation, on the theory that some aspects of the service provided occur on the ground. *See also Airborne Freight Corp. v. New York Dep't of Taxation*, 527 N.Y.S.2d 107, 109 (App. Div. 1988) (declining to decide whether state may tax portion of gross receipts attributed to air freight company's pickup and delivery because state raised argument too late in the proceedings). This question is squarely presented by the decision below, which upheld a state tax on *some* of the gross receipts from the sale of air transportation, to the extent those receipts are attributed to activities performed on the ground.

Importantly, the resolution of the question by the court below potentially subjects a substantial portion of the gross receipts from both property and passenger air transportation to state and local taxes. This Court's guidance is urgently needed to prevent a result inconsistent with the statutory provision and with this Court's interpretation of that provision.

B. This Is Not An Isolated Error of Law.

Although this Court does not undertake to correct every misunderstanding of law, the decision below does not represent an isolated mistake and will not have a limited effect. To the contrary, it is part of a pattern by Hawaii's Director of Taxation to evade Congress' prohibition of state taxes on gross receipts

from the sale of air transportation. If permitted to stand, the decision will influence other states and localities to impose similar taxes -- carving an enormous hole in Congress' state and local tax preemption scheme.

1. *Hawaii*

As this Court knows, *Aloha Airlines* itself was a Hawaii case accepted for certiorari because the Supreme Court of Hawaii had upheld a tax imposed on the gross receipts of airlines, notwithstanding Congress' express preemption of such taxes. 464 U.S. at 12. The Hawaii court had upheld the tax on the theory that the legislature, by *deeming* it a "property" tax, had placed the tax on gross receipts beyond the preemptive reach of the federal provision. *In re Aloha Airlines*, 647 P.2d 263, 274 (Haw. 1982). Even after this Court reversed, and expressly found the tax preempted, 464 U.S. at 14 n.10, that tax provision was not repealed or amended by the state legislature, nor were regulations to limit its scope adopted by the Director of Taxation.

Instead, the Director of Taxation has engaged in a fifteen-year effort to carve loopholes out of *Aloha Airlines*, and has continued to enforce the specific provision this Court found preempted against air carriers under various theories. For example, the year after this Court decided *Aloha Airlines*, the Director of Taxation denied an air cargo carrier, UPS, refunds of the taxes it had paid on its gross receipts from sales of air freight transportation before the decision issued. *See UPS*, 966 P.2d at 650. Although this Court had held that the federal provision preempted "state and local taxes on gross receipts derived from air transportation *or* the carriage of persons in air commerce," *Aloha Airlines*, 464 U.S. at 14-15 (emphasis added), and although the facts in *Aloha Airlines* involved both,

id. at 10, the Director of Taxation apparently based its claim on this Court's more extensive discussion of the preemption question with respect to airline passengers.[7]

In addition, the Director assessed gross receipts taxes on air freight transportation against Air Polynesia (d/b/a/ DHL Cargo). *See Air Polynesia, Inc. v. Freitas*, 742 F.2d 546 (9th Cir. 1984) (explaining factual background but finding that the Tax Injunction Act deprived lower federal courts of jurisdiction over the question). Air Polynesia then successfully appealed the Director's assessments in state court. The Tax Appeal Court held that the tax was preempted. *See Air Polynesia, Inc. v. Director of Taxation*, Docket No. 2250 (Haw. Tax Appeal Court May 24, 1985).

Meanwhile, Hawaii's Director of Taxation also attempted to impose tax under the same provision against an air tour operator on the ground that inter-island sightseeing flights through federal airways were not "travel" or "transportation" within the meaning of the preemption provision. *In re Panorama Air Tour, Inc.*, Docket No. 1931 at 6-7 (Haw. Tax Appeal Court Nov. 27, 1984). This attempted loophole was rejected by the Tax Appeal Court. *Id.* at 8.

The Director's current claim -- that Hawaii is permitted to apportion gross receipts from the sale of air transportation and tax the portion attributed to activities that occur on the ground -- is simply the most recent in an unswerving assault on Congress' preemption of state and local taxes. The Director's imposition of tax on apportioned gross receipts was twice found

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[7]The decision below similarly describes *Aloha Airlines* as holding that it was improper for Hawaii to assess a tax on gross receipts derived from the carriage of *passengers*. *See* Pet. App. 10a.

preempted by Hawaii's Tax Appeal Court, *see* Pet. App. 18a; *UPS v. Director of Taxation*, Docket No. 2235 (Haw. Tax Appeal Court Jan. 13, 1997), but has now twice been upheld by the Supreme Court of Hawaii. *See* Pet. App. 2a; *UPS*, 966 P.2d at 339.

2. *Other states; other taxes*

If the decision below is permitted to stand, not only will Hawaii, and possibly local jurisdictions within Hawaii, tax apportioned gross receipts from the sale of air freight transportation, but other states and localities can also be expected to follow. Further, they might well be emboldened to intrude still further into the air transportation industry, reaching passenger transportation as well. Interstate air transportation will be subjected to precisely the proliferation of state and local taxes Congress sought, through preemption, to prevent as "inimical to the development of a national system." S. Rep. No. 93-12 (1973), *reprinted in* 1973 U.S.C.C.A.N. 1434, 1455.

At the time *Aloha Airlines* was heard, at least 11 states in addition to Hawaii had enacted gross receipts taxes on the sale of air transportation. *See Amicus* Br. of Alaska, *et al.*, *Aloha Airlines*, Statutory Appendix; *Aloha Airlines*, 464 U.S. at 13 n.7, 14 n.10.[8] Today, approximately sixty jurisdictions, state and local, impose some type of gross receipts tax, but forgo imposing the tax on air carriers, presumably in the (correct) belief that such taxes are precluded by Section 1513 and its

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[8] The eleven states were: Alaska, Arizona, Delaware, Indiana, Maryland, Mississippi, New York, Ohio, Oklahoma, Washington, West Virginia. Currently, at least five states impose some type of gross receipts or sales tax on transportation. *See* Ariz. Rev. Stat. § 43-5062; Del. Code. Ann., tit. 30, § 2301(d)(1); N.M. Stat. Ann. § 7-9-4 ; Okla. Stat. § 68-1354(C); Wash. Rev. Code § 82.16.020.

successor provision. *See* John T. Piper & Catherine A. Eggen, *Gross Receipt Taxes: General Principles*, Tax Management § 1610.03.A.2, § 1610.6101-05 (Worksheet 1) (BNA 1998). The decision below, if not reversed, would be a green light encouraging those jurisdictions, and others, to tax substantial portions of air carriers' gross receipts. Nothing in the reasoning below limits its applicability geographically or jurisdictionally. Any state or locality looking for revenues could feel free to tax these receipts. Indeed, such taxes might be a particularly attractive revenue source for the local, urban jurisdictions in which many airports are located, as a source of needed funding ultimately provided by shippers and travelers, many of whom are located -- and vote -- elsewhere.

It is not unrealistic to expect these states and localities to react in precisely this way, as it has happened before in closely related circumstances. After this Court's decision in *Evansville-Vanderburgh Airport Authority District et al. v. Delta Airlines, Inc. et al.*, 405 U.S. 707 (1972) (upholding a New Hampshire head tax on air travelers), state and local head taxes proliferated. By the following year, at least 31 jurisdictions had adopted such taxes and proposals were pending in many others, a result Congress found "predictable." 1973 U.S.C.C.A.N. at 1446, 1450 (S. Rep. No. 93-12). Indeed, it was this proliferation that led Congress to preempt state and local taxes on the sale of air transportation. *Id.*

The apportionment theory, adopted below, would permit taxation of substantial amounts of the gross receipts from sales of air transportation. Not only air freight forwarders, but also airlines, perform the pickup, delivery, handling, and sorting functions for air packages and air freight on the ground. Under the reasoning below, the costs of these activities by airlines could also be used to apportion gross receipts from the sale of

air cargo transportation and subject them to tax.

The reasoning is also applicable to passenger travel. At the very least, under the exact same theory, the cost of issuing tickets and boarding passes and checking, handling, and sorting baggage -- all functions that take place on the ground -- could be used to apportion gross receipts from the sale of passenger tickets and subject them to tax. Arguably, the reasoning could reach further. Another portion of passenger ticket prices is used to maintain and repair aircraft -- functions performed on the ground. The cleaning crews perform their work on the ground. The meals and drinks, although consumed in the air, are prepared and packaged on the ground. Similarly, the staff who load fuel perform their work on the ground.

Apportioning gross receipts based on where functions are performed -- without regard to how integral the functions are to the air transportation service sold -- subjects a substantial proportion of air transportation receipts to the very state and local taxes Congress intended to preempt.

II. THIS COURT SHOULD GRANT CERTIORARI BECAUSE THE DECISION BELOW IS INCONSISTENT WITH CONGRESS' UNDERSTANDING AND POSES A SIGNIFICANT THREAT TO CONGRESS' EXPRESS GOALS.

A. Hawaii's Designation of Sorting, Marketing, Pickup and Delivery Functions As Separate From Air Services Conflicts With Congress' Views and Those of Its Designated Agency.

Hawaii's claim that it may permissibly subject gross receipts from the sale of air freight services to state tax, to the

extent the receipts can be attributed to activities that occur on the ground, is based on the unexplained and incorrect premise that these ground-based activities are separate services, divisible from air services. That premise, however, is contrary to common sense, business experience, Congress' understanding, and the expertise of the agency entrusted by Congress to encourage the development of air transportation.

1. Air transportation services

No air delivery system operates without incidental ground activity. Before a package is sent by air, it is picked up, sorted, and delivered to the aircraft. These functions take place on the ground. Similarly, before a passenger can be flown to a destination, the passenger is sorted (issued a ticket and boarding pass and sent by foot or internal subway to the proper gateway) and delivered to the aircraft (by covered ramp, mobile lounge, or bus). In addition, the passenger's baggage is handled, sorted, and delivered to the aircraft. These incidental ground activities are not thought of by the air carrier or the customer as separate services. They are simply part of what is required to transport anything or anyone by air. No one would purchase the handling and sorting of a package by an air carrier if the package was not being sent by air. No one would contract with an air carrier to pickup the package and take it to the aircraft, or, after the aircraft landed, to deliver the package to its destination from the aircraft, if the package were not being sent by air. Similarly, passengers would not buy the service of being issued a ticket, or having their baggage handled, if they were not undertaking an air journey.

As the Ninth Circuit recognized with respect to the pickup and delivery services of another air freight company: "The trucking operations of [the company] are integral to its

operation as an air carrier. The trucking operations are not some separate business venture; they are part and parcel of the air delivery system." *Federal Express Corp. v. California Pub. Utils. Comm'n*, 936 F.2d 1075, 1078 (1991). Thus, Hawaii's apparent assumption that Lynden and others have simply combined two different sets of services and offered them as a package to customers has no basis and is plainly wrong.

2. Congress and its designated agency considered the ground activities at issue here integral to the provision of air transportation services.

In order to further its express goal of encouraging the development of an adequate, efficient, and economical air transportation system serving the air transportation needs of this country, Congress delegated the Civil Aeronautics Board ("C.A.B."), and later the Secretary of Transportation, to carry out its air transportation policies. *See Federal Express Corp.*, 936 F.2d at 1079; 49 U.S.C. § 1302 (1988); 49 U.S.C. § 40101. In particular, Congress wanted to encourage development of an all-cargo air transportation system that would be responsive to the present and future needs of shippers, commerce generally, and national defense. *See id.* Congress specified that the all-cargo air transportation system should be "an expedited" system and "an integrated transportation system." *Id.* Air freight transportation that takes a package or freight from the sender to its final destination is therefore exactly the kind of an expedited, integrated all-cargo air transportation system Congress expressly specified. 936 F.2d at 1079.

In order to ensure that its air transportation policies were implemented, Congress distinguished even among different federal agencies to consign the regulatory responsibility for ground pickup and delivery of air packages to the agency

regulating *air* transportation, rather than to its sister agency regulating motor transportation. Specific provisions removed jurisdiction for such ground pickup and delivery functions from the Interstate Commerce Commission ("ICC"), later the Surface Transportation Board. *See, e.g.*, 52 Stat. 1029 (1938), *codified as* 49 U.S.C. § 303(b)(7a) ("Nothing in this chapter . . . shall be construed to include . . . (7a) the transportation of persons or property by motor vehicle when incidental to transportation by aircraft . . . .") (limiting jurisdiction of the ICC). A parallel provision, originally enacted the same year -- 1938, granted jurisdiction over such ground pickups and deliveries to the agency regulating air transportation. *See, e.g.*, 49 U.S.C. § 1373(a) (1988) (granting the authority to approve air carrier tariffs for air transportation, including "services in connection with such air transportation").

The Civil Aeronautics Board, for decades the agency charged with implementing Congress' policies with respect to the economic regulation of air transportation, understood that its delegated powers included the economic regulation of pickups and deliveries of air packages and air freight. Initially, it enacted a regulation exerting regulatory authority over all such pickups and deliveries to and from an airport, using a 25-mile radius as a method for distinguishing *bona fide* pickups and deliveries, but considering special circumstances that warranted exceeding the rule of thumb measure. *See, e.g., Law Motor Freight, Inc. v. C.A.B.*, 364 F.2d 139, 140-41 (1st Cir. 1966); 29 Fed. Reg. 6276 (1964); 14 C.F.R. Pt. 222 (1980).

The C.A.B.'s conclusions, based on its expertise and obligations to implement congressional policy, were that:

> full development of air cargo transportation depends, *in large measure*, upon efficient *surface* transportation;

> effective customer-oriented pickup and delivery service can best be guaranteed when it is under the control of the direct air carrier or the air freight forwarder; this control can be maintained by the operation of trucks directly by the air carrier and the air freight forwarder or under contract with local cartage agents; and a reasonable amount of freedom for the direct air carriers and air freight forwarders to establish pickup and delivery services and to test their adequacy and economy is *vital* to prevent a stifling of the potential of air cargo transportation.

Law Motor Freight, 364 F.2d at 141 (quoting the Preamble to Part 222) (emphasis added). The C.A.B. determined to consider proposed tariffs for extensions beyond the rule of thumb measure "in light of whether the proposed service is truly air cargo pickup and delivery. . . ." *Id.* Thus, the C.A.B. recognized that ground pickup and delivery were part of air cargo transportation and that, to further Congress' goals, these needed to be regulated as air transportation.

When it chose to deregulate both air and motor transportation, Congress removed federal regulation of air cargo pickup and delivery altogether in favor of market regulation. The power to review tariffs for air cargo pickup and delivery by the agency charged with implementing Congress' air transportation policies was eliminated, but Congress retained a provision expressly withdrawing authority from the agency charged with implementing Congress' motor transportation policies. *See* 49 U.S.C. § 13506(a)(8)(B) (denying Secretary of Transportation and Surface Transportation Board any authority over "transportation of property . . . by motor vehicle as part of a continuous movement which, prior or subsequent to such part of the continuous movement, has been or will be transported by an air carrier"). In this way, Congress implemented its policy of

"relying on competitive market forces to decide the extent, variety, quality, and price of services provided" as the best method for developing an integrated air cargo transportation system. 49 U.S.C. § 40101(b)(2).[9]

The decision below, by treating ground pickups and deliveries -- as well as sorting, handling, marketing, etc. -- as separate from air transportation and subjecting them to the vagaries of state and local tax provisions, is not only inconsistent with Congress' and the Department of Transportation's long-standing view of air cargo service, but also undermines Congress' determination that the market should be the regulator most likely to achieve its goal of an expedited, integrated air cargo transportation system capable of serving this nation's needs. It cannot be gainsaid that taxation is a very potent form of regulation.

B. Hawaii's Imposition of Tax On Gross Receipts Attributed to Ground-Based Functions Integral to Providing Air Transportation Undermines Congress' Preemption Scheme.

Congress' preemption scheme was intended to protect this country's air transportation system from the "inequitable, and potentially chaotic burden of [state and local] taxation" on those who use air transportation, because of "the chaos which such local taxation works on the national air transportation system." 1973 U.S.C.C.A.N. at 1446 (S. Rep. No. 93-12). Congress explained that state and local tax "runs counter to the whole concept of uniformity . . . and the maintenance of a national air

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[9]The Department of Transportation continues to have and assert authority to regulate ground pickups and deliveries in the United States by foreign air carriers. 14 C.F.R. § 222.1-222.4.

transportation system." *Id.* at 1450.[10]

Indeed, Congress *rejected* a proposal to permit a tax similar to the one upheld below when it considered, and originally enacted, its state and local tax preemption provision. The proposal was urged by the deputy tax commissioner of Ohio, testifying at the House hearings that the then-proposed bill should be amended to permit state taxes on gross receipts that are "fairly apportioned to a State."[11] Such a tax would have had virtually the same effect on the air transportation system as the tax at issue here because most of the portion of the gross receipts of air transportation that can be fairly apportioned to a state is the portion attributed to the ground activities that take place within that state. Congress, however, did not adopt the proposal and enacted the provision preempting such a tax instead. *See Aloha Airlines*, 464 U.S. at 14 n.7; Ohio Op. Atty. Gen. No. 73-117 (Nov. 20, 1973).

The tax upheld below, and those sure to follow if the decision is not reversed, present the very evils inherent in state

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[10]With respect to air cargo, for example, state and local taxes interfere with adopting a uniform national pricing structure. If a regional or national air transportation provider passes the taxes onto customers in the jurisdictions that impose them, the provider must create different rate structures depending on where each package starts and ends its journey. Packages from the same customer would even be priced according to different rate structures if they were headed to different destinations. If the regional or national air transportation provider adopts uniform national rates anyway, customers in Idaho and Delaware would wind up paying a portion of Hawaii's tax. This is exactly the type of chaos and inequity Congress enacted the preemption provision to prevent.

[11]Hearings on H.R. 4082, H.R. 2695, H.R. 4214, H.R. 4182 and S.38 Before the Subcomm. on Transportation and Aeronautics of the House Comm. on Interstate and Foreign Commerce, 93d Cong. at 248-49 (1973).

and local taxation of gross receipts from the sale of air transportation services that led Congress to preempt it. A central concern Congress had, with respect to state or local taxes, was that there were no "safeguards to prevent undue or discriminatory taxation." 1973 U.S.C.C.A.N. at 1446. Congress has long premised the development of a vibrant air transportation system on, *inter alia*, preventing discrimination. *See, e.g.*, 49 U.S.C. § 1302(c) (adopting as a central policy, the promotion of service by air carriers "without unjust discrimination, undue preferences or advantages"); 49 U.S.C. § 40101(a)(4). With deregulation, it became even more important to prevent state discrimination between air transportation providers because that would distort the market Congress is relying on to ensure the development of an efficient, and responsive air transportation system. *See* 49 U.S.C. § 40101(a)(6). Congress' express goals with respect to air transportation recognize that the public interest is furthered by "avoiding unreasonable industry concentration" and "excessive market domination" by any one or group of air transportation providers, and by "encouraging entry into air transportation markets by new and existing air carriers and the continued strengthening of small air carriers to ensure a more effective and competitive airline industry." § 40101(a)(10), (13).

State and local taxes, as Congress noted when it chose to preempt them, pose significant threats to these goals. Hawaii's tax already provides an example. Hawaii has imposed its "attributed to ground activity" gross receipts tax on petitioner and on UPS. Hawaii has not, however, imposed this tax on any airline even though several airlines, such as United and Delta, provide identical services -- including door-to-door pickup and delivery, sorting and handling of air freight and packages at a ground facility, administration, and marketing. R.A. 186-87, 197-200, 207-08. Regardless of whether Hawaii chooses to

maintain this distinction in the future, the fact is that it -- and every other state and local jurisdiction -- *can* do so, and can impose differential taxation in many other ways as well. State and local tax schemes, as Congress explained, threaten "undue or discriminatory taxation." Undue and discriminatory taxation slow the development of air transportation and encourage inefficient investment and usage. Taxes like Hawaii's favor certain providers over others, promote industry concentration, and interfere with new entry -- undermining Congress' express goals with respect to preemption and the development of air transportation generally.

Another concern that prompted Congress to preempt state and local taxes is that a proliferation of taxes would directly affect the cost of air transportation and that this added cost could make air transportation "uneconomical" for some potential customers "and thus inhibit the growth of the air transportation system." 1973 U.S.C.C.A.N. at 1451. Hawaii's imposition of the tax on a significant "portion" of gross receipts from the sale of air transportation, rather than on all of the gross receipts, provides no protection against the negative impact on air transportation that Congress determined to avoid. The basis on which the court below upheld Hawaii's tax could be a basis for every state and every locality with an airport to impose taxes on substantial portions of the gross receipts collected from the sale of air transportation. Very quickly, such taxes could place air freight and air packages out of the reach of many customers. If applied to passenger services as well, such taxes could have the same effect on air travel.

In fact, by simply increasing their tax rates, state and local jurisdictions could raise the cost of air transportation as much by taxing a *portion* of such gross receipts as by taxing all of them at a lower tax rate. For example, consider a state that

wished to collect revenues of four percent of the gross receipts from the sale of air transportation, but was permitted to collect tax only on the gross receipts attributed to ground activities. If the percentage of gross receipts that can be attributed to ground activities is 25 percent, the state could nonetheless collect the total revenues it desires by raising its tax rate on those gross receipts to 16 percent.[12]

Congress also objected to any tax by any jurisdiction on the sale of air transportation that was not being used for airport development. Congress found it "inequitable" that a state or local jurisdiction might impose a tax "to gain financial windfalls," *i.e.*, raise revenues for the jurisdiction's "general fund." 1973 U.S.C.C.A.N. at 1446 (objecting to a Philadelphia tax for that reason). The tax upheld below is precisely the type of tax Congress found unacceptable: a tax on the sale of air transportation to fill the state's general coffers.

Thus, the decision below contravenes Congress' statutory provision and its express goals, with respect to air transportation generally and state and local taxation specifically. The tax it upheld undermines Congress' express goals with respect to preemption, competition, and the efficient development of a responsive air transportation industry, including expedited, integrated air cargo services, presenting the very evils Congress acted to prevent. No useful purpose is served by awaiting the "predictable" proliferation of other state

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[12]*I.e.*, assuming the total gross receipts from the sale of air transportation in the state is $100 million, 4% of the entire $100 million generates the same tax revenues as 16% of the $25 million of receipts attributed to ground activities -- $4 million. Some limitation on a state or local jurisdiction's power is imposed by the equal protection clause, but it is well-settled that states enjoy a considerable degree of latitude in making tax classifications. *See, e.g.*, *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 359 (1973).

and local taxes, with the attendant damage they will cause, before deciding the question squarely and cleanly presented by the decision below. To the contrary, reviewing the decision below will permit the Court to clarify the scope of Congress' preemption provision and the scope of this Court's interpretation of that provision in *Aloha Airlines* in a significant factual context, relevant not only to Hawaii but to hundreds of state and local jurisdictions.

III. THIS COURT SHOULD GRANT CERTIORARI TO RESOLVE A LONGSTANDING CONFLICT OVER THE SCOPE OF THE STATUTORY DEFINITION OF INTERSTATE AIR TRANSPORTATION.

The court below interpreted the statutory definition of "interstate air transportation" to include only carriage by aircraft, based on the initial part of the provision explaining that "'interstate air transportation' means the transportation of passengers or property by aircraft. . . ." 49 U.S.C. § 40102(a)(25).[13] At least one other court, and arguably more, appear to have reached a similar conclusion with respect to the meaning of the statutory definition of "interstate air transportation." *See, e.g., Salem Trans. Co.*, 611 F. Supp. at

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[13]The preemption provision before the court prohibits states and localities from imposing a tax on the sale of "air transportation" or on the gross receipts from such sales. 49 U.S.C. § 40116(b), *see also* 49 U.S.C. § 1513(a). "Air transportation" is defined as "foreign air transportation, interstate air transportation, or the transportation of mail by aircraft." 49 U.S.C. § 40102(a)(5); *see also* 49 U.S.C. § 1301(10). Thus, the statutory definition of "interstate air transportation" affects the scope of the preemption provision. The court below relied on its reading of that statutory definition to conclude that a gross receipts tax on the sale of air cargo transportation was not precluded to the extent those receipts could be attributed to activities that took place on the ground.

257; *but see also City and County of Denver v. Continental Air Lines, Inc.*, 712 F. Supp. 834 (D. Colo. 1989); *Airline Car Rental, Inc. v. Shreveport Airport Auth.*, 667 F. Supp. 293 (W.D. La. 1986).

In contrast, two federal courts of appeal have relied on language that appears later in the statutory definition to conclude that the scope of "interstate air transportation" is much broader. That language adds: "when *any part* of the transportation is by aircraft." 49 U.S.C. § 40102(a)(25) (emphasis added). The United States Court of Appeals for the D.C. Circuit was the first court to interpret the substantively identical predecessor provision, and undertook a detailed analysis of its text and layout.[14] The court concluded that the later phrase modified "carriage by aircraft" such that commercial transportation, any part of which was by aircraft, is included in the definition of "interstate air transportation." *See, e.g., City of Philadelphia v. C.A.B.*, 289 F.2d 770, 773-74 (D.C. Cir. 1961). The Tenth Circuit reached the same conclusion. *See Hill v. National Trans. Safety Bd.*, 886 F.2d 1275, 1280 n.6 (10th Cir. 1989) (noting that "goods, persons, or mail traveling 'partly by aircraft and partly by other forms of transportation' are within the scope of interstate, overseas, or foreign air commerce or air transportation, *see* 49 U.S.C. § 1301").[15]

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[14]The equivalent language in the earlier statute was: "whether such commerce moves wholly by aircraft or partly by aircraft and partly by other forms of transportation." 49 U.S.C. § 1301(21).

[15]*See also Federal Express Corp.*, 936 F.2d at 1079 n.1 (Singleton, dissenting) (interpreting the statutory definition of air transportation "to include goods carried in part by aircraft and in part by trucks" and relying on that definition to conclude, contrary to the majority, that Congress did not further preempt state regulation of goods carried exclusively by truck).

Furthermore, because the same language is used in the statutory definitions of "interstate air commerce," "foreign air transportation," and "foreign air commerce," the same interpretative issue also arises in cases where one of these parallel definitions is at issue. *See* 49 U.S.C. § 40102(a)(22), (23), (24); *Hill v. National Transportation Safety Board*, 886 F.2d at 1280 n.6. Thus, for example, a federal district court in Seattle interpreted "foreign air commerce" -- consistently with *City of Philadelphia* but inconsistently with the decision below -- as "including commerce which moves wholly by aircraft or partly by aircraft and partly by other forms of transportation from any place outside the United States to a place in the United States." *United States v. Petrykievicz*, 809 F. Supp. 794, 799 (W.D. Wash. 1992).[16]

The decision below squarely presents the question whether Congress' statutory definition of "interstate air transportation" includes both air and land segments of a continuous, integrated transportation service from origin to destination, or whether that definition includes only that portion of the transportation moved by aircraft. That same interpretive question also controls the scope of the statutory definitions of "interstate air commerce," "foreign air transportation," and "foreign air commerce." The conflicting interpretations reached by different courts is inconsistent with Congress' goal of a uniform, national

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[16]The Department of Transportation also appears to view the term "air transportation" as including any transportation part of which is by air, contrary to the decision below. Thus, the agency explains that its regulations with respect to foreign air carriers apply to "all *air* transportation of property that includes both air movement by a direct foreign air carrier and surface transportation to or from any point within the United States." 14 C.F.R. § 222.1 (emphasis added).

policy with respect to air transportation.

This Court's review is needed to resolve the conflict, which affects a considerable range of state and federal responsibilities. The cases cited above, for example, interpret these statutory definitions not only in the context of tax preemption cases, but also in a criminal case involving the carriage of explosives, a challenge to a federal authorization to provide air transportation, a challenge to state regulations imposed on air cargo delivery trucks, and a challenge to a federal agency pilot disciplinary decision. Many provisions rely on these statutory definitions in defining the Department of Transportation's responsibilities and authority. *See, e.g.*, 49 U.S.C. § 41712 (conferring authority on the Secretary of Transportation to investigate and prevent unfair and deceptive practices and unfair methods of competition in air transportation or the sale of air transportation). Thus, the Court's resolution of this question would have a substantial legal and practical impact.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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